B4750-24

Economic Outlook

Irving Trust

Irving Trust Company
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New York, NY 10015

Economic Research &
Planning Division

May 1984

On a number of occasions businessmen have asked me why economists put so much stress on real GNP. Isn't it really, they ask, mainly of academic interest, with little relationship to their companies' performance? Developments so far this year show that real GNP growth does indeed matter, particularly with regard to pressures on interest rates.

In testimony before Congress in February, Mr. Volcker indicated that the Board of Governors and Federal Reserve Bank presidents generally expected real GNP to rise 4% to 4 3/4% from the fourth quarter of 1983 to the fourth quarter of 1984. Of course, the Fed's formal targets are in terms of growth in the monetary and credit aggregates. The sharp rise in real GNP in the first quarter, however--8.3% at an annual rate--meant that real growth must slow considerably if the Fed's formal targets are to be met. As a result, the Fed is not likely to relax its restrictive stance until evidence of an economic slowdown is visible.

A slowing in real growth is likely even aside from the tightening actions taken by the Fed. A considerable portion of the first quarter's growth was the result of a large buildup in inventories, some of which was undoubtedly undesired. As firms attempt to keep inventories from getting too far out of line with sales, reordering will be held back, increases in production will be dampened somewhat, and real GNP growth will slow. These developments do not occur in one or two months--indeed, the April data are very strong--but forces leading to a slowdown have been set into motion. Moreover, since the auto industry apparently has capacity constraints on producing more large cars, GNP growth is currently not getting a boost from domestic auto sales, as it did in the first quarter.

Our forecast calls for real GNP growth of 3.2%, 2.5%, and 3.8% in the second, third, and fourth quarters, or 4.4% from the fourth quarter of 1983 to the fourth quarter of 1984--within the Fed's anticipated range. (This increase is roughly average compared to prior recoveries.) If this slowing in growth does materialize, the Fed would be able to allow interest rates to drift lower, perhaps by late summer.

Early warning signals of potential inflationary pressures have also caused the Fed to tighten. The capacity utilization rate has risen unusually rapidly in this recovery, while the drop in the unemployment rate has been unprecedented. Although M1 has moved into the lower portion of the Fed's target band, domestic nonfinancial debt has expanded at a rapid pace. The target for this credit variable is 8% to 11% from the fourth quarter of 1983 to the fourth quarter of 1984, but the annualized growth rate was 12.5% from November to February. With short-term credit demand still strong, partly as a result of the buildup in inventories, data yet to be released will likely show that credit expansion is still well above target. A more restrained rate of inventory accumulation may contribute to a slowing in credit expansion, but for the time being rapid growth in credit and strong economic performance seem to have convinced the Fed to brush up on its hardball game.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual							Forecast	Actual	Forecast	
	1984	1984			1985				1982-	1983-	1984-
	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	12.8	7.2	6.9	8.7	9.8	8.1	10.2	10.6	7.7	9.9	8.9
Real GNP	8.3	3.2	2.5	3.8	4.5	2.5	4.0	4.0	3.4	5.7	3.6
GNP Price Deflator	4.1	3.9	4.3	4.7	5.1	5.5	6.0	6.3	4.2	4.0	5.1

	Actual	Forecast	Actual	Forecast	
	1984: I	1984:II	1982-1983	1983-1984	1984-1985
Consumer Spending	9.2%	7.6%	8.3%	9.0%	9.1%
Durable Goods	16.6	5.4	14.3	14.7	7.3
Nondurable Goods	9.7	5.3	5.7	7.5	6.8
Services	6.9	9.9	8.9	8.6	11.3
Business Capital Spending	11.4	18.6	0.0	16.8	14.2
Structures	22.7	18.9	-7.6	13.8	12.1
Equipment	5.4	18.4	5.2	18.7	15.4
Residential Investment	32.4	16.2	43.2	16.9	-1.5
			1983	1984	1985
Change in Inventories	$62.2b.	$39.9b.	$-6.4b.	$38.5b.	$38.3b.
Net Exports of Goods and Services	$-45.2b.	$-50.0b.	$-9.0b.	$-53.1b.	$-62.0b.
			1982-1983	1983-1984	1984-1985
Government Purchases	6.8%	14.6%	6.2%	7.5%	8.5%
Federal	1.3	30.6	6.2	8.2	11.7
Defense	20.6	11.2	11.6	12.7	13.9
Other	-43.4	124.8	-6.0	-4.0	4.5
State & Local	10.5	5.2	6.2	7.1	6.3
Corporate Profits Before Tax	46.1*F	21.0*	19.1	20.4	10.0
Corporate Profits After Tax	39.8*F	18.0*	13.5	16.7	10.0
Plant and Equipment Expenditures	14.5F	12.0	-4.4	15.3	12.5
Real Final Sales#	3.6	6.0	2.8	4.5	3.7
Real Disposable Personal Income	10.2	3.4	3.2	6.2	3.5

Economic Indicators	Recent Data			Actual	Forecast	
	Jan.	Feb.	Mar.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	7.2%	4.8%	2.4%	3.8%	4.7%	5.4%
Producer Price Index for Finished Goods**	7.2	4.8	6.0	0.6	4.7	5.3
Industrial Production	16.8	12.0	4.8	6.5	11.0	5.1
Retail Sales##	4.1	-1.0	-2.0	9.3	10.9	8.4
				1983	1984	1985
Auto Sales (millions of units, a.r.)	11.2	10.6	10.0	9.2	10.8	11.0
Housing Starts (millions of units, a.r.)	1.98	2.23	1.64	1.70	1.85	1.65
Unemployment Rate	8.0	7.8	7.8	9.6	7.5	6.7
Merchandise Trade Deficit (a.r.)	$113.6b.	$121.1b.	$123.3b.	$69.4b.	$112.5b.	$123.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

May 11, 1984

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast

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Economic Outlook

Irving Trust

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Economic Research &
Planning Division

June 1984

A few signs of a slowing in the economy helped spark a bond market mini-rally in early June, but many observers of the economy remain skeptical that the Federal Reserve will be able to pilot the economy to a soft landing. Our forecast places us in the optimistic camp, but the Fed will probably need all the skill--and luck--it can muster to maneuver through the turbulence.

The problem from the point of view of the financial markets is that the forward momentum of the economy has remained strong. During the first year of this recovery, the rise in real GNP (6.2% from the fourth quarter of 1982 to the fourth quarter of 1983) was exactly equal to the average of the comparable increases in four prior recoveries. With the substantial real growth in the first quarter of 1984, however, the current recovery moved ahead of the pack. If the increase in real GNP in the second quarter is 3.1% (at an annual rate) or greater, as is highly likely, the current recovery will be the strongest at this stage since the late 1950s. From such a perspective, it is no wonder that the Federal Reserve has become apprehensive about possible future inflationary pressures.

The recently released minutes of the Federal Open Market Committee meeting held in March show concern was expressed about persisting large federal deficits, exceptionally heavy credit demands, and rapidly rising levels of resource utilization. Implicit in the vague reference to the pending UAW contract negotiations with Ford and GM--the current contracts expire September 14--was the concern that past progress in containing inflation could be threatened by immoderate wage and benefit settlements. In addition, most of the reports on the economy's performance in April showed a sharp rebound from the weather-induced slowing in March, while domestic auto sales in May, at 8.6 million units at an annual rate, reached the highest level since 1979. The fiscal stimulus and pent-up demand for housing, autos, and capital goods have proved to be more powerful in supporting business expansion than the offsetting effects of monetary restraint.

The ideal solution--a soft landing--would be a significant slowing in economic growth without a recession or a sharp jump in interest rates. Increases in (real) interest rates do eventually curtail activity in certain sectors of the economy; but the timing and extent of the required rise in rates are not precise, especially with such relatively new developments as adjustable rate mortgages, which represented 60% of the mortgages closed in April. Nevertheless, some signs of weakness are evident. Sales of new single-family homes fell 4.9% in April from the March level; manufacturers' new orders, excluding defense, fell 1.0% in April; the average manufacturing workweek fell sharply in May; and the National Association of Purchasing Managers' survey indicated some softening of activity in May.

A slower rate of inventory accumulation after the first quarter's record increase will also help dampen real growth in the months ahead. Seemingly small differences in real growth, however, could prove important in the direction of Fed policy. So far, the Fed seems disposed to lean against the wind--with some (warranted) trepidation--until the economy cooperates and stops racing ahead.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual							Forecast	Actual	Forecast	
	1984	1984			1985				1982-	1983-	1984-
	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	12.8	7.6	6.9	8.3	9.8	8.1	10.3	9.7	7.7	9.9	8.8
Real GNP	8.8	3.8	2.5	3.4	4.5	2.5	4.0	3.2	3.4	5.9	3.5
GNP Price Deflator	3.7	3.7	4.3	4.7	5.1	5.5	6.0	6.3	4.2	3.8	5.1

	Actual	Forecast	Actual	Forecast	
	1984: I	1984: II	1982-1983	1983-1984	1984-1985
Consumer Spending	10.6%	8.3%	8.3%	9.3%	9.0%
Durable Goods	23.7	8.7	14.3	17.0	7.5
Nondurable Goods	9.2	6.8	5.7	7.5	6.8
Services	8.3	9.3	8.9	8.7	11.1
Business Capital Spending	11.6	18.7	0.0	16.7	14.1
Structures	19.9	19.0	-7.6	13.0	12.1
Equipment	7.2	18.5	5.2	19.1	15.2
Residential Investment	26.8	28.1	43.2	17.5	-2.4
			1983	1984	1985
Change in Inventories	$69.3b.	$48.8b.	$-6.4b.	$46.3b.	$44.8b.
Net Exports of Goods and Services	$-54.6b.	$-65.0b.	$-9.0b.	$-63.7b.	$-72.0b.
			1982-1983	1983-1984	1984-1985
Government Purchases	5.0%	15.5%	6.2%	7.1%	8.3%
Federal	-2.5	33.7	6.2	7.3	11.
Defense	14.1	11.1	11.6	11.1	13.9
Other	-41.9	144.1	-6.0	-3.0	4.6
State & Local	10.0	5.2	6.2	6.9	6.1
Corporate Profits Before Tax	41.8*	20.0*	19.1	19.6	10.0
Corporate Profits After Tax	37.2*	18.3*	13.5	17.2	10.0
Plant and Equipment Expenditures	14.5F	17.0	-4.4	14.9	12.5
Real Final Sales#	3.2	6.2	2.8	4.4	3.6
Real Disposable Personal Income	10.1	2.9	3.2	6.2	3.4

Economic Indicators	Recent Data			Actual	Forecast	
	Feb.	Mar.	Apr.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	4.8%	2.4%	6.0%	3.8%	4.7%	5.4%
Producer Price Index for Finished Goods**	4.8	6.0	0.0	0.6	4.7	5.3
Industrial Production	12.0	6.0	16.8	6.5	11.5	5.2
Retail Sales##	-0.8	-2.0	2.9	9.3	10.9	8.4
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.6	10.0	10.1	9.2	10.9	11.0
Housing Starts (millions of units, a.r.)	2.26	1.65	1.96	1.70	1.86	1.70
Unemployment Rate	7.8	7.8	7.8	9.6	7.5	6.
Merchandise Trade Deficit (a.r.)	$121.1b.	$123.2b.	$146.3b.	$69.4b.	$121.5b.	$131.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast

June 7, 1984

B4750-2

Economic Outlook

Irving Trust

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Economic Research & Planning Division

July 1984

Under most circumstances, the recent performance of the U.S. economy would be a policymaker's dream: rapid real growth, low inflation, and sharp reductions in the unemployment rate. Financial market participants and Federal Reserve officials, however, are focusing on indicators of potential inflationary pressures, and from this perspective some signs are disconcerting. For example, strong economic growth has brought the capacity utilization rate up to its long-term average, and continued robust growth, it is feared, would lead to inflationary capacity bottlenecks. These concerns will likely cause the Fed to maintain its existing degree of restraint, or perhaps even tighten a bit, until clear evidence of a slowing in the pace of economic activity is visible. Economic growth is likely to decelerate during the second half of 1984, but so far this year most of the economy's surprises have been on the side of strength rather than weakness.

Recent economic statistics present a mixed picture. Retail sales excluding autos showed moderate month-to-month increases of 0.4% in both May and June, while industrial production showed moderate increases of 0.4% in May and 0.5% in June. Another somewhat neutral variable now is initial claims for unemployment compensation benefits, which usually rise at the early stage of economic slowdowns, but instead have remained remarkably stable near the February-June average of 353,000 per week. As indications of the buoyancy of the economy, nonfarm payroll employment registered solid gains throughout the second quarter, and domestic auto sales remained strong in early July. Manufacturers' new nondefense orders, which as of May were only slightly above the February level, suggest a flattening in activity, while new home sales have declined steadily since February. All in all, these data indicate some tapering off in economic growth but no dramatic slowdown yet.

A slowing in real growth is likely later this year and early next year for several reasons. First, since (nonfarm) inventories rose at a substantial--and unsustainable--rate during the first half of this year, a slower rate of inventory accumulation will contribute to a diminution in real GNP growth. Second, current high interest rates will curtail demand in interest-sensitive sectors of the economy and related industries--such as home-building, construction materials, appliances, etc. --but with a considerable lag.

Part of the problem for the Fed in producing a slowing in the economy is that some rates--particularly consumer installment loan rates--are slow to react to increases in money market rates. For example, the rates on personal and new car loans at commercial banks were lower in May 1984 than in May 1983, despite increases in most other interest rates during the same period. As a result, the effects of restrictive actions by the Fed are often felt only after decisive moves maintained over extended periods. Of course, such policies run the risk of overstaying and producing a more substantial slowdown than desired. Our expectation is that the economy will soften but still avoid a recession through next year. The primary risk in this forecast, however, is not that the economy will soon become too weak, but that its forward momentum will continue to appear too strong.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual							Forecast	Actual	Forecast	
	1984	1984			1985				1982-	1983-	1984-
	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	14.0	8.7	7.0	7.6	7.0	8.6	10.1	8.8	7.7	10.4	8.0
Real GNP	9.7	5.7	3.2	3.0	2.2	4.0	4.7	3.0	3.4	6.5	3.4
GNP Price Deflator	3.9	2.8	3.7	4.5	4.7	4.4	5.2	5.6	4.2	3.6	4.5

	Actual	Forecast	Actual	Forecast	
	1984: I	1984: II	1982-1983	1983-1984	1984-1985
Consumer Spending	10.3%	10.2%	8.3%	9.6%	8.3%
Durable Goods	24.0	16.6	14.3	18.0	6.6
Nondurable Goods	9.1	9.4	5.7	8.2	6.4
Services	7.7	9.0	8.9	8.5	10.2
Business Capital Spending	13.1	18.6	0.0	17.3	14.1
Structures	22.0	18.9	-7.6	13.4	12.2
Equipment	8.4	18.4	5.2	19.8	15.2
Residential Investment	28.6	9.8	43.2	14.9	-2.0
			1983	1984	1985
Change in Inventories	$71.0b.	$51.5b.	$-6.4b.	$48.1b.	$40.0b.
Net Exports of Goods and Services	$-48.2b.	$-58.2b.	$-9.0b.	$-57.7b.	$-67.2b.
			1982-1983	1983-1984	1984-1985
Government Purchases	5.0%	16.7%	6.2%	7.3%	8.1%
Federal	-3.2	36.3	6.2	7.5	11.4
Defense	13.0	14.0	11.6	11.5	13.9
Other	-41.9	144.1	-6.1	-3.4	3.8
State & Local	10.6	5.5	6.2	7.1	5.9
Corporate Profits Before Tax	44.0*	23.0*	19.1	20.7	10.0
Corporate Profits After Tax	40.1*	22.1*	13.5	19.1	10.0
Plant and Equipment Expenditures	13.6	16.1	-4.8	14.4	12.5
Real Final Sales#	3.9	8.3	2.8	5.1	3.7
Real Disposable Personal Income	10.0	4.5	3.2	6.5	3.4

Economic Indicators	Recent Data			Actual	Forecast	
	Apr.	May	June	1982-1983	1983-1984	1984-1985
Consumer Price Index**	6.0%	2.4%	n.a.	3.8%	4.6%	5.3%
Producer Price Index for Finished Goods**	0.0	0.0	0.0	0.6	4.1	5.1
Industrial Production	10.8	4.8	6.0	6.5	11.0	4.9
Retail Sales##	3.5	0.5	0.8	9.3	11.7	8.4
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.1	11.1	11.0	9.2	10.9	11.0
Housing Starts (millions of units, a.r.)	1.99	1.78	n.a.	1.70	1.86	1.70
Unemployment Rate	7.8	7.5	7.1	9.6	7.5	6.7
Merchandise Trade Deficit (a.r.)	$146.3b.	$106.1b.	n.a.	$69.4b.	$129.5b.	$139.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

July 17, 1984

#GNP less change in inventories, both in real terms.
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B4750-2

Economic Outlook

Irving Trust

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Economic Research &
Planning Division

August 1984

In the upside-down world of the financial markets, recent signs of a slowing in the economy were welcome news that contributed to a significant stock market rally in late July and early August. Indications of a cooling in the economy, such as recent declines in leading indicators and consumer confidence, have become more numerous, but the evidence is far from conclusive. The 0.9% increase in industrial production in July from the June level, combined with the 0.9% increase in June (which was revised upward from a preliminary estimate of 0.5%), underscores the persistent strength of the economy. Real growth in the second half of this year is likely to be at a much slower, more sustainable pace than during the first half, while short-term interest rates will probably not show major changes in the months ahead. The economy is expected to continue to advance through 1985, with real GNP rising 6.0% from the fourth quarter of last year to the fourth quarter of this year and 3.4% from the fourth quarter of 1984 to the fourth quarter of 1985.

The current economic recovery, which began near the end of 1982, proved remarkably normal during its first year and was widely expected to continue on a normal path of more moderate growth during its second year. Instead, the economy raced ahead during the first half of this year, and recent data revisions now show even faster growth than originally reported. As a result, this recovery has now had the most rapid rebound in real GNP from its trough level since the expansion that began in late 1949. Clearly, this is no longer an average recovery. Fortunately (from the financial markets' point of view), forces now seem to be at work that will produce a slowdown in economic growth, but the extent of the slowdown will strongly influence the direction of interest rates.

The ratio of manufacturers' inventories to sales has risen steadily during 1984 and, while still at a seemingly low level, to some extent reflects an undesired buildup. As an indication of an imbalance, inventories of finished goods rose sharply in June following substantial increases in April and May, while inventories of raw materials fell slightly in June. This pattern suggests that manufacturers are trying to hold down purchases of raw materials, which are relatively controllable, until their inventories of final products begin to move more quickly.

U.S. manufacturers of home goods and apparel, whose products represent a key area of discretionary consumer spending, have already felt the slowdown. After a series of declines, their new orders in June were barely above last December's level, while the book value of their inventories had risen by a substantial 6.7% during the same period. The 0.9% decline in retail sales in July from the June level indicates that new orders will continue to be soft. The inevitable result will be restraints on output until inventories move into a more comfortable relationship with sales. Of course, any such generalizations invite exceptions, and the auto industry is a prime example now. Dealers' inventories are relatively lean, with some popular models in short supply. This is one area that could produce faster than expected overall economic growth. In sum, the evidence mounts that a slowdown is commencing, but it's still worth remembering--as the Fed certainly must--that most of the surprises this year have been on the side of strength.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
	1984				1985				1982-	1983-	1984-
	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	14.9	10.9	7.2	7.4	7.2	8.6	9.9	8.6	7.7	11.1	8.2
Real GNP	10.1	7.5	3.5	3.0	2.4	4.0	4.6	2.8	3.7	7.1	3.5
GNP Price Deflator	4.4	3.2	3.6	4.3	4.7	4.4	5.1	5.6	3.8	3.8	4.4

	Actual	Forecast	Actual	Forecast	
	1984: II	1984:III	1982-1983	1983-1984	1984-1985
Consumer Spending	9.1%	8.9%	8.6%	9.0%	8.0%
Durable Goods	10.4	10.1	14.2	15.2	7.4
Nondurable Goods	8.1	7.8	5.8	8.0	7.1
Services	9.5	9.4	9.4	8.2	8.8
Business Capital Spending	24.3	18.7	0.9	21.7	17.0
Structures	30.9	20.0	-8.7	19.3	16.6
Equipment	20.8	18.0	7.6	23.1	17.2
Residential Investment	15.1	-2.0	44.6	16.5	-1.7
			1983	1984	1985
Change in Inventories	$53.8b.	$39.0b.	$-13.5b.	$49.9b.	$32.3b.
Net Exports of Goods and Services	$-58.0b.	$-60.2b.	$-8.3b.	$-58.5b.	$-67.2b.
			1982-1983	1983-1984	1984-1985
Government Purchases	25.8%	7.2%	5.4%	8.8%	9.0%
Federal	56.5	11.1	4.2	10.4	13.8
Defense	15.7	12.8	11.7	12.0	13.3
Other	328.9	6.2	-12.7	5.4	15.4
State & Local	9.4	4.7	6.2	7.8	5.9
Corporate Profits Before Tax	27.6*F	12.9*F	22.8	24.6	11.5
Corporate Profits After Tax	26.9*F	11.4*F	21.6	23.0	11.5
Plant and Equipment Expenditures	20.0	16.0	-4.8	15.9	14.9
Real Final Sales#	10.4	5.1	3.2	5.5	4.2
Real Disposable Personal Income	8.6	5.9	3.5	6.6	3.5

Economic Indicators	Recent Data			Actual	Forecast	
	Apr.	May	June	1982-1983	1983-1984	1984-1985
Consumer Price Index**	5.9%	3.5%	3.9%	3.8%	4.5%	5.1%
Producer Price Index for Finished Goods**	-1.2	0.4	-1.2	0.6	4.1	5.1
Industrial Production	10.8	4.8	10.8	6.5	11.9	5.3
Retail Sales##	3.5	0.5	0.5	9.3	11.7	8.4
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.2	11.0	10.8	9.2	10.9	11.0
Housing Starts (millions of units, a.r.)	2.02	1.81	1.89	1.70	1.87	1.74
Unemployment Rate	7.8	7.5	7.1	9.6	7.5	6.7
Merchandise Trade Deficit (a.r.)	$146.3b.	$106.1b.	$106.9b.	$69.4b.	$129.5b.	$139.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

August 16, 1984

#GNP less change in inventories, both in real terms.
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*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast

Economic Outlook

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Economic Research & Planning Division

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The economy now seems to be headed toward a soft landing. A few months ago, the financial markets were concerned that rapid economic growth would continue relentlessly, forcing the Federal Reserve to tighten policy and risk recession sometime next year. Fortunately, recent economic developments indicate that a soft landing is likely. As evidence of the slowing in the pace of economic activity, nonauto retail sales fell sharply in July (on a month-to-month basis) and were flat in August, while housing starts dropped sharply in August to 1.54 million units, the lowest level since December 1982, when the recovery was just getting started. We expect real GNP to show an increase of 3.4% at an annual rate in the current quarter (compared to a steamy 10.1% increase in the first quarter), 3.7% in the fourth quarter, 2.5% in the first quarter of next year, and 3.6% for 1985 as a whole, with continued expansion throughout the year.

The slowing in economic growth, though welcomed by monetary policymakers, is not occurring in the most desirable manner: A significant portion of the deceleration in real GNP growth in the third quarter is due to the enlargement of the merchandise trade deficit. July's deficit was $168.7 billion at an annual rate, almost a quadrupling of the 1982 deficit. This horrendous deficit is probably unrepresentative of deficits in coming months, but it is likely that the deficits will remain relatively large. We estimate that the merchandise trade deficit will total $130 billion in 1984 and $139 billion in 1985.

Foremost among the various factors that account for the enlargement of the trade deficit is the appreciation of the dollar, which has risen 50% since July 1980, based on the Irving Trust Effective Dollar. The relative performance of unit labor costs illustrates the competitive difficulties a rising dollar imposes on U.S. manufacturers. Unit labor costs in the United States rose at a compound annual rate of 3.9% from 1980 to 1983. Measured in each nation's own currency, the comparable increases were 2.6% for Germany, 5.9% for the United Kingdom, and 10.5% for France. On a U.S. dollar basis, however, unit labor costs declined 8.4% per annum in Germany, 8.2% in the United Kingdom, and 9.3% in France. Such cost differentials make it difficult for U.S. manufacturers to compete against foreign products both at home and abroad. The need for U.S. manufacturers to remain competitive has encouraged many firms to invest heavily in the most advanced capital goods. This may partially explain the remarkable strength of business investment in this recovery, although--ironically--much of the equipment purchased is imported.

The deterioration of the U.S. balance on merchandise trade can also be attributed to the sluggish recoveries abroad, the difficulties less developed countries are experiencing servicing their substantial debt burdens, healthy gains in real disposable personal income in the U.S., and strong demand for items such as consumer electronics products (VCRs, etc.), many of which are simply not made in the U.S. The unbalanced nature of the worldwide recovery, however--strong growth in the U.S. and Japan, lackluster growth in Western Europe, and intense economic problems among many LDCs--indicates that this recovery may yet have an unusual amount of running room.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual		1984		Forecast				Actual	Forecast	
								1985	1982-	1983-	1984-
	I	II	III	IV	I	II	III	IV	1983	1984	1985
Gross National Product	14.9	10.7	6.5	7.8	7.1	8.7	9.7	8.4	7.7	11.0	8.1
Real GNP	10.1	7.1	3.4	3.7	2.5	4.1	4.3	2.6	3.7	7.0	3.6
GNP Price Deflator	4.4	3.3	3.0	4.0	4.5	4.4	5.1	5.6	3.8	3.7	4.3

	Actual	Forecast	Actual	Forecast	
	1984: II	1984:III	1982-1983	1983-1984	1984-1985
Consumer Spending	10.2%	5.3%	8.6%	8.8%	7.7%
Durable Goods	13.2	3.7	14.2	15.0	8.1
Nondurable Goods	8.3	1.2	5.8	7.2	6.4
Services	10.8	9.0	9.4	8.4	8.6
Business Capital Spending	24.0	22.2	0.9	21.9	17.2
Structures	23.8	24.0	-8.7	18.5	16.6
Equipment	23.7	21.2	7.6	23.9	17.5
Residential Investment	12.2	-2.0	44.6	15.9	-1.9
			1983	1984	1985
Change in Inventories	$50.6b.	$53.0b.	$-13.5b.	$55.9b.	$39.3b.
Net Exports of Goods and Services	$-58.7b.	$-74.0b.	$-8.3b.	$-63.6b.	$-73.3b.
			1982-1983	1983-1984	1984-1985
Government Purchases	24.3%	11.1%	5.4%	9.0%	9.4%
Federal	50.5	13.0	4.2	9.7	13.6
Defense	14.6	13.3	11.7	11.8	13.0
Other	278.5	12.0	-12.7	3.5	15.5
State & Local	10.1	9.8	6.2	8.6	6.6
Corporate Profits Before Tax	24.1*	8.2*	22.8	21.6	8.9
Corporate Profits After Tax	21.7*	5.3*	21.6	18.8	8.6
Plant and Equipment Expenditures	13.7	20.0	-4.8	15.3	14.2
Real Final Sales#	10.3	2.5	3.2	5.2	4.1
Real Disposable Personal Income	6.3	4.2	3.5	6.8	3.9

Economic Indicators	Recent Data			Actual	Forecast	
	June	July	Aug.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	2.4%	3.6%	6.0%	3.8%	4.6%	5.0%
Producer Price Index for Finished Goods**	0.0	3.6	-1.2	0.6	3.1	5.0
Industrial Production	10.8	10.8	2.4	6.5	11.4	5.6
Retail Sales##	1.0	-2.0	-0.8	9.3	9.9	7.8
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.8	10.6	10.0	9.2	10.7	10.7
Housing Starts (millions of units, a.r.)	1.88	1.76	1.54	1.70	1.78	1.66
Unemployment Rate	7.1	7.5	7.5	9.6	7.5	6.8
Merchandise Trade Deficit (a.r.)	$106.9b.	$168.7b.	n.a.	$69.4b.	$129.5b.	$139.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast

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